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California Corporation and Personal Income Taxes

By BRUCE W. WALKER* and HEBARD P. SMITH**

California income taxes (Personal Income Tax and Bank and Corporation Tax) are an integral and important part of the state revenue system. For the fiscal year ended June 30, 1959, these taxes produced total revenues of \$334,555,463.¹ This constitutes 28.6 per cent of the revenues of the General Fund and makes these taxes second in importance to the Sales and Use Tax as a revenue producer for the General Fund.²

These taxes are administered by the Franchise Tax Board. Both have substantive and procedural identities and similarities and many of the sections contained in one law are found in the other. This article discusses each tax separately with a third part devoted to administrative details which are common to both laws.

I. The Personal Income Tax Law

The power of the state to impose a personal income tax seems never to have been subject to question. Specific authority to impose such a tax has been in the California Constitution since its adoption in 1879.³ In addition, the well-recognized rule that the Legislature has unlimited powers except as restricted by the Constitution makes constitutional authorization for this form of taxation unnecessary.⁴

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(The opinions expressed in this article are those of the authors and do not necessarily reflect the views of the Franchise Tax Board.)

¹ The Personal Income Tax produced \$160,552,772, the Bank and Corporation Tax \$174,002,691. The percentage of the total that these taxes contribute to the General Fund is: Personal Income Tax 13.7%; Bank and Corporation Tax 14.9%. CALIF. FRANCH. TAX Bd., *Annual Report*, 1959 at viii.

² Retail Sales and Use Tax collections totaled \$631,514,497 or 53.9% of the General Fund revenue. Other taxes totaled \$204,819,835 or 17.5% of the total General Fund revenue. CALIF. FRANCH. TAX Bd., *Annual Report*, 1959 at viii.

³ CAL. CONST. art. XIII, § 11.

⁴ *Security Savings, etc., Co. v. Hinton*, 97 Cal. 214, 32 Pac. 3 (1893); *In re Madera Irrigation District*, 92 Cal. 296, 28 Pac. 272, 28 Pac. 675 (1891); *Beals v. Amador County*, 35 Cal. 624 (1868); *Roth Drug, Inc. v. Johnson*, 13 Cal. App. 2d 720, 108 P.2d 728 (1936). For an extended discussion on the constitutionality of the Personal Income Tax Act of 1935; see Traynor and Keesling, *The Scope and Nature of the California Income Tax*, 24 CALIF. L. REV. 493 (1935-36).

The possibility of a state income tax in California was considered as early as 1906; however, a commission then making a study of the California tax system rejected the income tax as "theoretically good, but practically unworkable and un-American."⁵ By 1929 the attitude towards a state income tax had changed. Inequities and the inability of local assessors to properly enforce taxes on personal property, intangibles and solvent credits led the California Tax Commission to recommend that a personal income tax be substituted for taxes on personal property and intangibles and that the latter taxes be abolished.⁶ Although no action was taken on the recommendation, the large fiscal deficit in state revenues during the early 1930's caused the State Legislature in 1933 to vote both a two and one-half per cent retail sales tax and a personal income tax with rates varying from one to five per cent.⁷ Although the sales tax was enacted, the income tax was vetoed by the Governor. When large deficits in state revenue continued, it was generally agreed that the imposition of a personal income tax was not only advisable but inevitable and the Personal Income Tax Act passed the Legislature in 1935 and was approved by the Governor June 16, 1935.⁸

The 1935 Act was based primarily upon the Revenue Act of 1934 and contained many of its provisions. Rates ranged from one to fifteen per cent and it was estimated that the tax would yield about 18 million dollars. While the objective of the California Tax Commission in having the personal income tax substituted for taxes on personal property and intangibles was not achieved, the Legislature did repeal the tax on bonds and shares of capital stock.⁹

Public interest in the law has been high since its adoption as indicated by three attempts to amend or repeal it by the initiative process. The first attempt to repeal was made in 1936, followed by a second in 1942. Both of these attempts were defeated.¹⁰ In 1958 an unusual initiative proposal appeared on the November ballot as Proposition Number 17. This proposition would have increased rates under the Personal

⁵ See CALIF. TAX COMM., FINAL REPORT at 51 (1929).

⁶ *Id.* at pp. xxiii and 92-100.

⁷ See Traynor and Keesling, *The Scope and Nature of the California Income Tax*, *supra* note 6 at 494.

⁸ CAL. REV. & T.C. § 212. The section reads: "Notes, debentures, shares of capital stock, bonds, deeds of trust, mortgages, and any interest in such property are exempt from taxation." Enacted by Cal. Stat. 1939, ch. 154, p. 1282. Formerly POL. CODE § 3627a. The Code was amended in 1935 to effect the exemption upon adoption of a personal income tax. Cal. Stat. 1935, ch. 834, p. 2251.

⁹ Cal. Stat. 1935, ch. 6969, § 69 p. 1090.

¹⁰ 1936 Prop. No. 2, Yes-737,629, No-1,193,225; 1942 Prop. No. 4, Yes-763,700, No-907,311. SEC. STATE, *Statement of Vote*.

Income Tax Law to a maximum of 46 per cent and reduced California Sales Tax from three to two per cent. This proposal was defeated by a wide margin.¹¹ Whether the term "popular" can ever be applied to an income tax law is perhaps questionable. At least the foregoing record indicates a substantial degree of public acceptance of the California law as it has evolved over the years.

As with federal income tax law, the California picture has been one of extreme change, dozens of bills affecting it being introduced at practically every session of the legislature, a significant number of these being adopted. At the 1959 session, for example, 18 bills affecting the law were introduced, of which four were adopted. To a large degree the Personal Income Tax Act of 1935 was based on the Federal Revenue Act of 1934. The influence of federal legislation can be seen in the many amendments which have become law since 1935. Pressures for "federal conformity" except as to rates and exemptions have been strong throughout the law's existence. To a considerable extent, conformity was achieved for years prior to the adoption of the Internal Revenue Code of 1954.

The Revenue Act of 1954 recast the federal law into a somewhat different form making dozens of substantive changes. The California law was rearranged to conform with federal law,¹² but pressures to adopt the substantive changes of the Revenue Act of 1954 have met with resistance. Conformity bills introduced at the 1955, 1957, 1959 and 1960 legislative sessions failed to pass. The failure of conformity bills in recent legislative sessions may be attributed to the loss of revenue which would have resulted from the proposed amendments, the state's revenues being inadequate for a number of years. The argument that the loss of revenue from bringing the state law into conformity with the federal could easily be made up by upward revision of rates seems to have no political appeal. At present the problem of federal conformity is still receiving considerable legislative attention, along with the possibility of adoption of general withholding provisions similar to the federal. Changes in these areas seem to be a distinct possibility in the future.

Subjects Taxed, Rates, Exemptions and Credits

The subjects taxed are individuals,¹³ estates and trusts.¹⁴ Partnerships are not taxed as such, the distributive shares of partners being

¹¹ Yes-888,523, No-4,033,101. SEC. STATE, *Statement of Vote*.

¹² Cal. Stat. 1955, ch. 939, p. 1655.

¹³ CAL. REV. & T.C. § 17041.

¹⁴ CAL. REV. & T.C. § 17731.

reported and taxed on the returns of the individual partners.¹⁵ The law contains no provision similar to the federal law allowing unincorporated business enterprises to be treated as corporations nor does it provide for corporations to be treated as partnerships.¹⁶

The tax applies both to residents and nonresidents. Residents are taxed on their entire income irrespective of source, while nonresidents are taxed only on income from California sources.¹⁷ In computing the taxable income of nonresidents, the deductions allowable are restricted to those connected with California income except for certain taxes and contributions.¹⁸

The taxable income of estates and trusts is determined in the same manner as that of individuals with special rules relating to charitable contributions,¹⁹ the standard deduction,²⁰ and distributable net income.²¹ The residence of estates depends upon the residence of the decedent while that of trusts depends upon the residence of the fiduciary and beneficiary.²²

Returns are required from the subjects taxed in all cases if annual gross income is \$5,000.00 or more or the net income exceeds the personal exemption,²³ disregarding the head of household, blind exemptions and credits for dependents. Returns of taxpayers on a calendar-year basis are due on April 15. Returns of taxpayers on a fiscal-year basis must be filed on or before the fifteenth day of the fourth month following the close of the taxpayer's accounting period.²⁴ The tax is payable with the filing of the return.²⁵ However, if the tax is more than \$50.00, the taxpayer may elect to pay in three installments at four-month intervals, the first payment not being less than \$50.00.²⁶

In determining taxable income, the following exemptions and dependent credits are allowed:²⁷

Single Individual	\$1,500.00
Head of Household	3,000.00
Married Couple	3,000.00
Blind Individual (Additional)	600.00

¹⁵ CAL. REV. & T.C. § 17851.

¹⁶ INT. REV. CODE OF 1954 §§ 1361, 1371-1377.

¹⁷ CAL. REV. & T.C. § 17041.

¹⁸ CAL. REV. & T.C. §§ 17301-04.

¹⁹ CAL. REV. & T.C. § 17734.

²⁰ CAL. REV. & T.C. § 17738.

²¹ CAL. REV. & T.C. §§ 17751, 17761.

²² CAL. REV. & T.C. §§ 17742-17744.

²³ CAL. REV. & T.C. §§ 18401, 18405.

²⁴ CAL. REV. & T.C. § 18432.

²⁵ CAL. REV. & T.C. § 18551.

²⁶ CAL. REV. & T.C. § 18552.

²⁷ CAL. REV. & T.C. §§ 17181, 17733.

Estate	1,000.00
Trust (Increase to \$200.00 where tax is \$1.00 or less)	100.00
Dependent	600.00

The rates start at one per cent and rise one per cent for each \$2,500.00 additional taxable income to seven per cent on the amount over \$15,000.00.²⁸ Due to the income-splitting provision applicable to joint returns of married couples, the effective rate structure applicable to joint returns is one per cent on the first \$5,000.00, rising to seven per cent on amounts over \$30,000.00.²⁹ An optional tax table is provided for individuals whose adjusted gross income is less than \$5,000.00 (\$10,000.00 for married couples).³⁰ Present rates, exemptions, and credits for dependents were enacted by the 1959 Legislature and apply to years beginning after December 31, 1958.³¹

²⁸ CAL. REV. & T.C. § 17041.

²⁹ CAL. REV. & T.C. § 17045.

³⁰ CAL. REV. & T.C. § 17048.

³¹ CAL. REV. & T.C. §§ 17041, 17045, 17171, 17181, 17733.

Prior rates, exemptions and credits were:

RATES				
1935 to 1942, Inclusive				
0 to \$ 5,000	.....		1%	
\$ 5,000 to 10,000	.....	\$ 50 plus	2% of amount over \$ 5,000	
10,000 to 15,000	.....	150 plus	3% of amount over 10,000	
15,000 to 20,000	.....	300 plus	4% of amount over 15,000	
20,000 to 25,000	.....	500 plus	5% of amount over 20,000	
25,000 to 30,000	.....	750 plus	6% of amount over 25,000	
30,000 to 40,000	.....	1,050 plus	7% of amount over 30,000	
40,000 to 50,000	.....	1,750 plus	8% of amount over 40,000	
50,000 to 60,000	.....	2,550 plus	9% of amount over 50,000	
60,000 to 70,000	.....	3,450 plus	10% of amount over 60,000	
70,000 to 80,000	.....	4,450 plus	11% of amount over 70,000	
80,000 to 100,000	.....	5,550 plus	12% of amount over 80,000	
100,000 to 150,000	.....	7,950 plus	13% of amount over 100,000	
150,000 to 250,000	.....	14,450 plus	14% of amount over 150,000	
over 250,000	.....	28,450 plus	15% of amount over 250,000	
1943 to 1948, Inclusive				
0 to 10,000	.....		1%	
10,000 to 15,000	.....	100 plus	2% of amount over 10,000	
15,000 to 20,000	.....	200 plus	3% of amount over 15,000	
20,000 to 25,000	.....	350 plus	4% of amount over 20,000	
25,000 to 30,000	.....	550 plus	5% of amount over 25,000	
over 30,000	.....	800 plus	6% of amount over 30,000	
1949 to 1958, Inclusive				
0 to 5,000	.....		1%	
5,000 to 10,000	.....	50 plus	2% of amount over 5,000	
10,000 to 15,000	.....	150 plus	3% of amount over 10,000	
15,000 to 20,000	.....	300 plus	4% of amount over 15,000	
20,000 to 25,000	.....	500 plus	5% of amount over 20,000	
over 25,000	.....	750 plus	6% of amount over 25,000	

In order to give relief from double taxation at the state level, a credit against the California tax is allowed for taxes paid other states, territories or possessions of the United States, but not for taxes paid foreign countries.³² The credit is available to nonresidents only if the state of residence grants a similar credit to California residents or does not tax them.³³ As to residents, the credit is allowable only for taxes paid on income taxable by the other state irrespective of the residence or domicile of the individual.³⁴ Thus if the individual is taxed by California and another state as a resident, he will be relieved of double taxation only to the extent his income is from sources within the other state without regard to his residence or domicile. This rule does not apply to estates and trusts, such entities being treated as residents of any state which taxes their income whether derived from sources within such state or not.³⁵

Major Differences Between State and Federal Laws

The plan of the state law is similar to the federal, using such familiar concepts as gross income,³⁶ adjusted gross income,³⁷ capital assets,³⁸ trade or business expenses,³⁹ expenses for the production of income,⁴⁰ statutory nonbusiness deductions, personal exemptions and taxable income. Despite the similarity between the two laws, a recent review showed approximately two hundred substantive differences between the laws as they existed in 1959. Discussed below are a number of major differences, the criteria for their selection being the number of taxpayers affected and the magnitude of the tax effect of the difference.

Benefits of split income provisions on joint returns applicable to 1952 and subsequent years.

EXEMPTIONS AND DEPENDENT CREDITS

Taxable Years 1935 to 1958

Years	Single	Married	Head of house- hold or Family	Blind	Dependent	Estate	Trust
1935-38	\$1,000	\$2,500	\$2,500	\$. . .	\$400	\$1,000	\$1,000
1939-42	1,000	2,500	2,500	. . .	400	1,000	100
1943-44	2,000	3,500	3,500	. . .	400	1,500	100
1945-48	3,000	4,500	4,500	500	400	1,500	100
1949-58	2,000	3,500	3,500	500	400	1,000	100

³² CAL. REV. & T.C. §§ 18001-18011.

³³ CAL. REV. & T.C. § 18002.

³⁴ CAL. REV. & T.C. § 18001.

³⁵ CAL. REV. & T.C. § 18004.

³⁶ CAL. REV. & T.C. § 17071.

³⁷ CAL. REV. & T.C. § 17072.

³⁸ CAL. REV. & T.C. § 18161.

³⁹ CAL. REV. & T.C. § 17202.

⁴⁰ CAL. REV. & T.C. § 17252.

Various transactions, while creating tax consequences under both laws, are accorded different treatment under the state law. Some of the more important are:

Annuities are still taxed under the three per cent rule followed by the Internal Revenue Code prior to 1954. Under this rule three per cent of the cost of annuity must be reported as income each year, the remainder of each year's receipts being excluded until such time as the amount excluded equals the cost or other basis. After recovery of the cost the full amount received must be reported as income. Under this provision the recovery of cost or other basis is deemed to have occurred even though the law may not have been in effect during a portion of the period when payments were received or may not have applied to the particular annuitant because of nonresidence.⁴¹

Non-cash patronage dividends from farm co-operatives and mutual associations may at the option of the recipient be reported at face value in the year of receipt or may be reported in the year of redemption or realization. In order to protect the state's interest, a special statute of limitation applies to those who elect to defer the reporting of such income. Under this statute a deficiency for the year of realization may be assessed at any time within four years from the date the taxpayer notifies the Franchise Tax Board that the dividend has been realized upon. The wording of the statute does not limit its application to deficiencies arising from exclusion of the gain on the realization of the dividend.⁴²

Gains and losses on the sales, exchange and involuntary conversion of assets are generally treated the same as for federal purposes but there are a number of exceptions as to what assets are capital assets, what assets are accorded capital gain and loss treatment, and in the determination of basis. As examples, federal and state noninterest-bearing obligations issued at a discount and maturing within one year are not capital assets,⁴³ short-term non-business bad debts are not treated as short-term capital losses,⁴⁴ sale of coal with a retained economic interest is not accorded capital gain treatment⁴⁵ and differences in bases exist as to taxes capitalized.⁴⁶ Many additional differences in basis and adjusted basis exist because of differences in rules applicable

⁴¹ Compare INT. REV. CODE OF 1954, § 72 with CAL. REV. & T.C. § 17101.

⁴² CAL. REV. & T.C. § 17117.5. No comparable Internal Revenue Code section, but see B. A. Carpenter, 20 T.C. 603 (1953).

⁴³ Compare INT. REV. CODE OF 1954 § 1221, with CAL. REV. & T.C. § 18161.

⁴⁴ Compare INT. REV. CODE OF 1954 § 166(d), with CAL. REV. & T.C. § 17207

⁴⁵ INT. REV. CODE OF 1954 § 631(c). No comparable California provision.

⁴⁶ INT. REV. CODE OF 1954 § 164(d). Absence of a comparable state provision results in the capitalization of certain taxes for state purposes which are deductible for federal purposes.

at the date of acquisition of assets and depreciation and depletion allowable.

Rules applicable to deductions are similar but again important areas of difference do exist, some of the more important being:

1. In determining adjusted gross income, local travel expenses of employees and local expenses of outside salesmen are not deductible.⁴⁷ The result here does not directly affect taxable income where deductions are itemized but it may do so indirectly by affecting the allowable amount of contributions and medical expenses, these deductions being affected by the amount of the adjusted gross income.

2. Allowances for depreciation will usually be practically the same as to assets acquired prior to January 1, 1954, and subsequent to December 31, 1958, but as to those acquired in the interim period a difference will exist where the taxpayer elected to claim a so-called accelerated method of depreciation for federal purposes.

Percentage depletion allowances for state purposes⁴⁸ are as follows:

Sand, gravel, slate, stone, etc.	5%
Coal, asbestos, etc.	10%
Metals, aplite, etc.	15%
Sulphur	23%
Oil and gas	27.5%

Where state and federal rates are not the same, the federal rate is always more liberal and as to a few minerals federal law allows percentage depletion where the state does not.⁴⁹ Differences also exist in "gross income from the property" on which percentage depletion is allowable, and there is no state provision as to the aggregation of separate interests. The last mentioned difference is of considerable importance because of the limitation of percentage depletion to 50 per cent of the net income from the property.

Interest paid or accrued is deductible but no provision is made for the deduction as interest of carrying charges on installment sales. Taxes deductible include a number of federal excise taxes imposed on the taxpayer and do not include income taxes of any kind.⁵⁰

Medical and adoption expenses are limited to the amount that such expenses exceed five per cent of the adjusted gross income except as to taxpayers over sixty-five years old, and the maximum allowable

⁴⁷ Compare INT. REV. CODE OF 1954 § 62, with CAL. REV. & T.C. § 17072.

⁴⁸ CAL. REV. & T.C. §§ 17686-7.

⁴⁹ INT. REV. CODE OF 1954, § 613(b)6 provides a 15% rate on "all other minerals," whereas CAL. REV. & T.C. § 17687(c) limits the allowance to metal mines and other named minerals.

⁵⁰ CAL. REV. & T.C. § 17204.

is \$1,250.00 for single individuals and \$2,500.00 for married couples and heads of household. There is no one per cent rule in respect to medicines and drugs.⁵¹

Illegal activities are given special treatment in that expenses in connection with them are not deductible.⁵² The illegal activities covered are those listed in Chapters 9, 10 and 10.5 of Title 9 of Part 1 of the Penal Code. These chapters include such activities as lotteries, illegal gambling, bookmaking and toutting. The validity of the provision has been upheld in *Hetzel v. Franchise Tax Board*⁵³ but further litigation appears certain. At the present time a great number of cases involving this provision are on appeal to the Board of Equalization from the action of the Franchise Tax Board.

II. The Bank and Corporation Tax Law

Drastic changes were made in the method of taxing banks and corporations in 1929. Prior to 1929, banks had been taxed on the book value of their shares after a deduction for the assessed value of the bank's real property which was taxed locally.⁵⁴ Corporate franchises were taxed on the value of their franchise on a property tax basis.⁵⁵

Serious doubts as to the validity of the tax on banks and administrative difficulties and inequities of the tax on corporate franchises lead a special tax commission to recommend that the previous method be abandoned and that both banks and corporations be subject to taxation "according to or measured by net income."⁵⁶ Recommendations of the commission were accepted by the adoption of a constitutional amendment in 1928,⁵⁷ followed by enactment of the Bank and Corporation Franchise Tax Act in 1929.⁵⁸ While material changes were made in the early years of operation, the basic plan of taxing banks and corporations measured by net income remains the same.⁵⁹

In 1933 the Massachusetts or Business Trust Act was enacted⁶⁰ and

⁵¹ CAL. REV. & T.C. §§ 17253-17260.

⁵² CAL. REV. & T.C. § 17297.

⁵³ 161 Cal. App. 2d 224, 326 P.2d 611 (1958).

⁵⁴ The tax was assessed against the owners of the bank shares; however, the bank was required to collect the tax and pay it to the state on behalf of the shareholders. In the course of time, the tax came to be considered in fact a tax on the banks. CALIF. TAX COMM., SPECIAL REPORT at 14 (Aug. 1928). CALIF. TAX RESEARCH BUR., SUMMARY REPORT at 73 (Dec. 1932).

⁵⁵ See note 1 *supra*; SUMMARY REPORT at 73, *supra* note 56.

⁵⁶ CALIF. TAX COMM., SPECIAL REPORT (Aug. 1928).

⁵⁷ CAL. CONST., art. XIII, § 16; amended, June 17, 1933.

⁵⁸ Cal. Stat. 1929, ch. 13, p. 19.

⁵⁹ As to the nature of the early changes, see Traynor and Keesling, *Recent Changes in the Bank and Corporations Franchise Tax Act*, 21 CALIF. L. REV. 543 (1932-33), 22 CALIF. L. REV. 499 (1933-34), 23 CALIF. L. REV. 51 (1934-35).

⁶⁰ Cal. Stat. 1933, ch. 211, p. 708.

in 1937 the Corporation Income Tax Act,⁶¹ both supplementary to the tax on the banks and corporations. The Corporation Income Tax Act was amended in 1939 to include Massachusetts or Business Trusts and the tax applicable to the latter organizations was repealed.⁶²

Both the Bank and Corporation Franchise Tax Act and the Corporation Income Tax Act have been amended frequently since their enactment.⁶³ In 1949, the Franchise Tax Law together with the Corporation Income Tax Law was incorporated into the Revenue and Taxation Code as Part II, Division 2, thereof.⁶⁴ The codification was effective July 1, 1951, and the codified law was titled the Bank and Corporation Tax Law.⁶⁵ As presently constituted the law provides a comprehensive plan for the taxation of all banks and corporations, other than insurance companies⁶⁶ and corporations specifically exempted by the provisions of the law.

Although the Bank and Corporation Franchise Tax Act and the Corporation Income Tax Act are now consolidated, the fundamental differences between these two laws remain. The franchise tax (Chapter 2) is imposed upon the privilege of doing business in the state measured by the corporation's net income or that portion thereof attributable to sources within the state.⁶⁷ The corporation income tax (Chapter 3) is a direct tax on the net income of corporations derived from or attributable to sources within the state.⁶⁸ All corporations except those specifically exempt are taxed under the franchise tax or the corporation income tax, but not both. Likewise, offsets are allowed if the tax imposed by one chapter is paid or collected under the other.⁶⁹

The franchise tax applies to all California corporations except holding companies, and all foreign corporations doing any intrastate business in the state. Foreign corporations engaged exclusively in foreign or interstate business in California or deriving income attributable to sources within the state, domestic holding companies and foreign holding companies which have acquired a commercial domicile in the state, and Massachusetts or Business Trusts are taxed under the corporation income tax. Except as to banks and financial corporations, the rate is

⁶¹ Cal. Stat. 1937, ch. 765, p. 2184.

⁶² Cal. Stat. 1939, ch. 1049.

⁶³ The acts have been amended in every regular session of the legislature excepting 1941, and in numerous special sessions.

⁶⁴ Cal. Stat. 1949, ch. 557, p. 961.

⁶⁵ CAL. REV. & T.C. § 23001.

⁶⁶ Insurance companies are subject to tax on gross premiums. They are exempt from franchise and income taxes. CAL. CONST., art. XIII, § 14 4/5.

⁶⁷ CAL. REV. & T.C. § 23151.

⁶⁸ CAL. REV. & T.C. § 23501.

⁶⁹ CAL. REV. & T.C. § 23503.

5.5 per cent of net income, with a minimum tax of \$100.00 for corporations taxed under the franchise tax provisions.⁷⁰ Corporations taxed under the corporation income tax provisions are not subject to the minimum tax.⁷¹

Banks located in the state are subject to the franchise tax (measured by income) at a higher rate than general business corporations. The rate is determined by a flexible formula which adds to the 5.5 per cent rate on general corporations a per cent equivalent to the percentage of the net incomes of general business corporations which they pay in state and local personal property taxes; provided, however, that the maximum rate cannot exceed 9.5 per cent.⁷² The tax so imposed is in lieu of all other taxes except taxes on their real property.⁷³

Reasons for the higher rate on banks is that they pay no personal property taxes. The higher rate is for the purpose of equalizing the tax burden of banks with that of general business corporations which do pay personal property taxes. Financial corporations doing business in the state are taxed at the bank rate; however, since they pay personal property taxes, they are allowed to offset against the tax, state and local personal property taxes paid during the year, except that after allowance of the offset, the state tax shall not be less than 5.5 per cent of their net income.⁷⁴ Financial corporations are subject to the minimum tax of \$100.00 whereas banks are not.

Comparison with the Federal Income Tax Law

In a large degree the state law follows the pattern of the federal law with respect to the determination of net income, filing of returns and administration of the law. The most commonly reoccurring and most important differences between the two laws arise out of the franchise tax provisions taxing corporations doing business in the state measured by their prior year's income. In addition to this major difference, arising primarily with the franchise tax provisions, there are innumerable minor variations which total over one hundred. Although, as with the Personal Income Tax Law, there has been considerable pressure for conformity with federal law, the time lag between passage of the federal law and incorporation of the changes in the state law and the opposition to changes which will reduce the state's revenue from these taxes has resulted in most of the variations.

Corporation tax returns are due March 15, if on a calendar year

⁷⁰ CAL. REV. & T.C. § 23151.

⁷¹ CAL. REV. & T.C. § 23501

⁷² CAL. REV. & T.C. § 23186.

⁷³ CAL. REV. & T.C. § 23182.

⁷⁴ CAL. REV. & T.C. § 23184.

basis, or on the 15th day of the third month following the close of the accounting period, if on a fiscal year basis.⁷⁵ Extensions may be granted for the filing of returns and payment of the tax for a period of six months from the due date.⁷⁶ If an extension is requested, California law does not require an estimated tax payment as does the federal; however, such a payment will avoid the running of interest.

Returns filed by mail are deemed filed on the date placed in the United States mails provided they are properly addressed with postage prepaid.⁷⁷ This is different from the federal rule which requires that returns be mailed in time to reach the District Director on the due date.⁷⁸

A taxpayer filing an amended federal return is required to file an amended California return within ninety days. Also, if a change or adjustment is made in net income by the federal tax authorities, or if income is changed by renegotiation, the changes must be reported within ninety days of the date of final determination of the federal change.⁷⁹ Failure to comply with these requirements extends the running of the statute of limitations on the issuance of deficiency assessments.⁸⁰

Taxpayers other than banks and financial corporations may pay the tax in two installments, provided the tax exceeds \$100.00 and the first installment is not less than \$100.00. The first installment is payable on the due date of the return and the second installment six months thereafter.⁸¹ If, in the case of a commencing corporation, an additional tax is due at the close of the taxable year, the full additional tax is due with the filing of the return.⁸²

Banks and financial corporations are required to pay as the first installment the full amount of the tax shown to be due on the return at the rate applicable to general business corporations. The second installment is due on the 15th day following notice from the Franchise Tax Board of the determination of the tax rate or the 15th day of the

⁷⁵ CAL. REV. & T.C. § 25401.

⁷⁶ CAL. REV. & T.C. § 25402.

⁷⁷ CAL. GOV. C. § 11003.

⁷⁸ Under INT. REV. CODE OF 1954 § 7502, a "claim, statement, or other document" is deemed to have been filed on the date the envelope is stamped with a United States postmark. The section excepts tax returns, which must be filed in time to reach the Director's Office on the due date. See *Crude Oil Corp. v. Comm.* 161 Fed. 2d 809 (1947), as to presumption of delivery when return is mailed in time to reach the Collector's Office on the date the return was due.

⁷⁹ CAL. REV. & T.C. § 25432.

⁸⁰ CAL. REV. & T.C. § 25673.

⁸¹ CAL. REV. & T.C. §§ 25551, 25551a.

⁸² CAL. REV. & T.C. § 23222.

ninth month following the close of the income year, whichever is later.⁸³

Although corporation income taxes are applicable much the same as the federal taxes, the franchise tax terminology is somewhat confusing inasmuch as franchise taxes are paid during the fiscal year on the preceding year's income. The year in which the tax is paid is called the "taxable year"⁸⁴ and the tax is for the privilege of exercising the corporate franchise during such year. The tax for the taxable year is measured by the income of the preceding year, known as the "income year."⁸⁵ This method of treatment gives rise to special treatment of commencing corporations and of corporations dissolving or withdrawing from the state.

Despite the numerous minor differences between the state and federal tax laws, the computation of net income for most corporations does not vary materially from that reported for federal tax purposes. On page one of the California form are a number of questions similar to those on the federal form. On page two are to be copied the same figures from page two of the federal form. Adjustments of federal net income are then made, the most common of which are as follows:

1. California and other taxes on or measured by net income (including federal income taxes and the California franchise and income taxes) are not deductible for state purposes.⁸⁶

2. Interest on tax exempt securities is includible in the measure of the franchise tax, but not the corporation income tax.⁸⁷

3. Net loss carry-over or carry-back is not allowed for state purposes.⁸⁸

4. Dividends received from other corporations are deductible to the extent declared from income already taxed under the corporation income tax provisions or included in the measure of the franchise tax.⁸⁹

5. Provisions of the state law with respect to depreciation of property used in the business or held for the production of income, depletion and amortization, are now generally the same as the federal. However, variations do exist and allowances for these deductions may

⁸³ CAL. REV. & T.C. §§ 25552-25552a.

⁸⁴ CAL. REV. & T.C. § 23041.

⁸⁵ CAL. REV. & T.C. § 23042.

⁸⁶ CAL. REV. & T.C. § 24345.

⁸⁷ CAL. REV. & T.C. § 24272. Under the Corporation Income Tax Law interest on bonds of the Federal Government is exempt. Interest on bonds of the State of California and its political subdivisions issued on or after November 4, 1902, is also exempt. Interest on California obligations issued prior to that date and on obligations of other states and foreign countries is taxable.

⁸⁸ The state law has no provision comparable to INT. REV. CODE OF 1954 § 172.

⁸⁹ CAL. REV. & T.C. § 24402, and see *Rosemary Properties, Inc. v. McColgan*, 29 Cal. 2d 677, 177 P.2d 757 (1947), *Burton E. Green Investment Co. v. McColgan*, 60 Cal. App. 2d 224, 140 P.2d 451 (1943).

be different under the two laws because of differences in the basis of the property. Because of these differences reference should be made to the various sections involved.

6. The California law has no provision for capital gains and losses. There is no distinction between capital assets and other assets, no long and short term gain categories, no limitation on the deductibility of losses from the sale of property, and no special treatment like that provided for under the federal law for certain transactions involving business property and for timber and coal. Recognized gains and losses on sales or exchanges of property are taken into account in full in computing net income for state purposes. The federal law has extensive rules regarding capital gains and losses and severely limits the deductibility of capital losses.

7. The federal law permits a deduction for all interest paid or accrued on an indebtedness of the taxpayer except interest incurred to carry tax-free obligations and interest on certain indebtedness incurred in connection with single premium life insurance and annuity contracts. In addition to these limits on the interest deduction, interest expense of a corporation whose income is determined by the allocation formula is further limited under the California law, viz:

(a) The interest is first deducted against interest income subject to allocation by formula up to the amount of such interest income.

(b) The interest is next applied as an offset against interest and dividend income (excluding dividends deductible which have been taxed under the franchise or corporation income tax provisions) that is not subject to allocation by formula.

(c) Any interest expense remaining is deductible from income subject to allocation by formula.⁹⁰

8. The California law contains no provisions similar to those of the federal law whereby shareholders of small business corporations may elect to be taxed as partnerships.

In addition to the differences mentioned, innumerable minor differences require reference to the sections involved in the preparation of tax returns.

Commencing Corporations — Franchise Taxes

Upon the organization of a California corporation or the qualification of a foreign corporation to do business in the state, it must pay the \$100.00 minimum tax as a prepayment for the first year of doing business.⁹¹ The total tax for the first taxable year is determined at the close

⁹⁰ CAL. REV. & T.C. §§ 24425, 24344.

⁹¹ CAL. REV. & T.C. § 23221.

of the year on the basis of the corporation's net income for the first year as shown by the return filed on or before the 15th day of the third month following the close of the accounting period, a credit being allowed for the prepayment.⁹² At the time it files its return for the first year, it also pays the tax (or the first installment thereof) for the second taxable year based upon its income for the first taxable year. If the initial accounting period was not a full year, the tax for the second taxable year is treated as a prepayment for such year, the tax for both the second and third years being computed on the basis of the income for the second tax year. Likewise, if by reason of a change in the accounting period the second taxable year is a period of less than twelve months, the commencing corporation's prepayment procedure is continued until the last short period is succeeded by a taxable period of twelve months. In either of these cases, the income of the last short period, if greater than the income of the succeeding twelve-month period, is used as a measure of the tax for the twelve-month period.⁹³

If a corporation which has been subject to the corporation income tax commences to do business in the state, it files an income tax return and pays the corporation income tax for the year in which it commences to do business. The income of the next year is used as a measure of the franchise tax for two years, applying the rules as applicable to commencing corporations. In this situation no franchise tax is paid for the first year of doing business and no advance payment is required at the beginning of the second year. The tax is paid twice on the income of the second year, once as a tax for the second taxable year and once for the third taxable year.⁹⁴

The foregoing rules do not apply to a corporation which commences to do business as a result of a reorganization.⁹⁵ In reorganizations the transferor and transferee corporations are treated as one continuing corporation. If the fiscal or accounting year of both corporations ends at the same time, or if the fiscal year of the transferor ends prior to the fiscal year of the transferee, the transferee corporation merely includes within the measure of its tax the income of the transferor corporation and no return is required of the transferor. If on the other hand, the fiscal year of the transferee ends after the fiscal year of the transferor, the transferee files a separate return including therein the income of the transferor, paying a separate tax on such income.⁹⁶

⁹² CAL. REV. & T.C. § 23222.

⁹³ CAL. REV. & T.C. § 23222a.

⁹⁴ CAL. REV. & T.C. § 23224.

⁹⁵ CAL. REV. & T.C. § 23252.

⁹⁶ CAL. REV. & T.C. §§ 23253, 23254.

Dissolution, Withdrawal and Cessation of Business

The dissolution of a domestic corporation and a withdrawal of a foreign corporation from the state, unless pursuant to a reorganization, will affect the tax liability of the corporation for the taxable year the dissolution or withdrawal occurs. The tax is imposed on the corporation for the privilege of doing business during the taxable year measured by the corporation's prior year's income and is based on the assumption that the corporation will be doing business for the entire taxable year. Hence, if it dissolves or withdraws from the state, its tax liability for the year of dissolution or withdrawal will be measured by a fraction of the income year's net income. The fraction is determined by the number of months of the year during which the corporation exercised its franchise. For the purpose of determining this fraction less than one-half of a month is disregarded while one-half or more of a month is considered a full month.⁹⁷

For tax purposes a dissolution or withdrawal from the state is effective when the appropriate documents are filed with the Secretary of State, and before a corporation may dissolve or withdraw it must present to the Secretary of State a certificate of the Franchise Tax Board to the effect that all taxes have been paid or properly secured.⁹⁸ Thus, in the case of an intended dissolution or withdrawal, appropriate steps must be taken by the corporation's representatives to obtain a tax clearance certificate and to file appropriate documents with the Secretary of State in order to avoid a continuing liability. A request for a tax clearance certificate should be made to the Franchise Tax Board thirty days prior to the date on which the dissolution or withdrawal is contemplated.⁹⁹

A corporation which ceases to do business in California but does not dissolve or withdraw from the state is not liable for taxes measured by income for years subsequent to the taxable year it ceased doing business. However, it is liable for the minimum tax until dissolved and if it resumes doing business its tax for the year business is resumed is measured by the income of the year of cessation of business. The corporation may become liable for corporate income taxes, however, if it receives income from sources in the state. If the corporation thereafter resumes doing business, the tax is computed the same as a cor-

⁹⁷ CAL. REV. & T.C. § 23332; 18 CAL. ADM. C. Regs. 23331-23334.

⁹⁸ CAL. REV. & T.C. § 23331. See Appeal in *Ida Mae Rogers*, CAL. ST. BD. OF EQUAL., August 10, 1950; CCH 1 CAL. TAX CASES ¶200-101; P-H ST. & LOC. TAX SERV. Cal. ¶13107, holding that a dissolution was effected on the date a proper and adequate certificate was offered to the Secretary of State, notwithstanding that the documents were returned to the taxpayer for additional information.

⁹⁹ See note 48 *supra*.

poration changing from liability under the corporation income tax to the franchise tax provisions.¹⁰⁰

Doing Business — Multi-State Income

Except as to banks and domestic corporations, whether a corporation is doing business in the state determines whether it is taxed under the franchise or income tax provisions. Doing business is defined as "actively engaged in any transaction for the purpose of financial or pecuniary gain or profit."¹⁰¹ This includes the purchase and sale of stocks or bonds, lending money, endorsing notes of a subsidiary corporation by a parent corporation and the leasing of real property by a parent corporation to a subsidiary and other tenants, and liquidating activities consisting of sales, rentals, collections on notes, etc.¹⁰² However, the mere collection of accounts receivable or engaging in litigation arising out of completed contracts is not doing business within the meaning of the section.¹⁰³

If the corporation's entire business activities are in the state and it receives no income from property located or having a business situs outside the state, no problem arises—the entire income of the corporation is included in the measure of the tax. If the corporation engages in business activities outside the state, however, or if it receives income from property located or having a situs outside the state, the tax is measured only by that portion of the corporation's income that is attributable to business done or property located in the state. Income from real or tangible property (including gains from the sale or disposition thereof) is income from California sources if the property is located in the state. Income from intangible property, such as interest, dividends, royalties from patents, trademarks, etc., including gains from the sale thereof, is attributable to the domicile of the corporation; however, if the corporation has acquired a commercial domicile in

¹⁰⁰ CAL. REV. & T.C. § 23281.

¹⁰¹ CAL. REV. & T.C. § 23101.

¹⁰² 18 CAL. ADM. C. Reg. 23101; *People v. Birch Securities Co.*, 86 Cal. App. 2d 703, 196 P.2d 143 (1948) (lending money); *People v. Alexander Goldstein Co.*, 66 Cal. App. 2d 711, 152 P.2d 1016 (1944) (purchase & sale of stocks and bonds); *Appeal of Reno Liquor Co.*, CAL. ST. BD. OF EQUAL., Feb. 17, 1959; CCH 2 CAL. TAX CASES ¶ 201-248; P-H, ST. & LOC. TAX SERV. Cal. ¶ 13201 (management function in California). A corporation selling its products in California through a distributor is not doing business in California. *Appeal of Sugar Creek Pine Co.*, CAL. ST. BD. OF EQUAL., March 30, 1955; CCH, 2 CAL. TAX CASES ¶ 200-307; P-H, ST. & LOC. TAX SERV. Cal. ¶ 13146 (collecting interest on notes & perfecting title to real estate in the process of liquidation); *Appeal of Snap-On Tools Corp.*, CAL. ST. BD. OF EQUAL., Dec. 29, 1958; CCH, 2 CAL. TAX CASES ¶ 201-200, P-H, ST. & LOC. TAX SERV. Cal. ¶ 13195.

¹⁰³ *Appeal of Johnson Foundry and Machine Co.*, CAL. ST. BD. OF EQUAL., Nov. 17, 1948; P-H STATE & LOCAL TAX SERV. Cal. ¶ 10232.60; FRANCH. TAX BD., LEGAL MEMORANDA Nos. 118, 119, July 1951.

California or if the property has acquired a business situs in this state, it is attributable to California sources. A corporation has a commercial domicile in California if its principal or head office is located in the state or if it is managed or controlled from within the state. Intangibles have a business situs in California if employed as capital within the state or if their possession or control has been localized in connection with a business, trade or profession in California.¹⁰⁴

Under California law, the income of a corporation doing business in the state may be determined by the use of an allocation formula, by separate accounting, or by any other method as is fairly calculated to determine income attributable to sources in the state.¹⁰⁵ Although use of the separate method of accounting is permitted for corporations having separate businesses in and outside the state, it has been the policy of the Franchise Tax Board to require formula allocations in all cases where the business activities within and without the state are unitary in nature. A business is considered unitary if the activities within the state contribute directly or indirectly to those outside the state. Examples of a unitary business are manufacturing or purchase outside the state and sale of the company's product in California,¹⁰⁶ centralized management¹⁰⁷ and rendition of services partly within and partly without the state (e.g., transportation). A corporation may be engaged exclusively in interstate commerce, yet have substantial activities in the taxing state.¹⁰⁸ While such a corporation is subject to the corporation income tax provision, in most cases there is little practical difference whether the corporation is taxed under the franchise or income tax provisions. The rate of tax is the same and in most cases the income will be the same.

The point of controversy which more frequently arises under the corporation income tax provisions is whether the activities of the corporation are such as to subject the corporation to any tax at all. The Franchise Tax Board has a fairly comprehensive regulation as to activities of a foreign corporation in California which will give rise to tax liability.¹⁰⁹ Generally a foreign corporation making sales to customers

¹⁰⁴ CAL. ADM. C. Regs. 23040(a), 24301; *Southern Pacific Co. v. McColgan*, 68 Cal. App. 2d 48, 156 P.2d 81 (1945).

¹⁰⁵ CAL. REV. & T.C. § 25101. Allocation of income is the subject of a special article.

¹⁰⁶ *Butler Bros. v. McColgan*, 315 U.S. 501 (1941), *affirming* 17 Cal. 2d 664, 11 P.2d 334 (1941); *John Deere Plow Co. v. Franchise Tax Board*, 38 Cal. 2d 214, 238 P.2d 569 (1951), *appeal dismissed*, 343 U.S. 939 (1952); *El Dorado Oil Works v. McColgan*, 34 Cal. 2d 731, 215 P.2d 4 (1950), *appeal dismissed*, 340 U.S. 801 (1950); *Edison California Stores, Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947).

¹⁰⁷ *Ibid.*

¹⁰⁸ *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1950).

¹⁰⁹ 18 CAL. ADM. C. Reg. 23040(b).

in California is subject to tax if it has either property or employees in in the state, and, conversely, it is not taxed if neither of these are present.

The application of the corporation income tax has been somewhat restricted by federal legislation enacted in 1959 limiting the power of the states to tax income from interstate commerce.¹¹⁰ This legislation was enacted to narrow the effect of two decisions of the United States Supreme Court holding that the individual states had broad powers to tax foreign corporations engaged exclusively in interstate commerce, provided the tax did not discriminate against such commerce and was properly apportioned to local activities within the taxing state.¹¹¹ The federal law effective September 14, 1959, prohibits a state from imposing a tax on income derived from interstate commerce, provided: (1) the activities within the state are limited to the solicitation of orders for sales of tangible personal property by employees or other representatives; (2) orders are sent outside the state for approval; and (3) orders are filled from stocks of goods maintained outside the state. The prohibition against taxing income from interstate commerce applies also to a corporation which sells through a sales office maintained within the state by independent contractors whose only activities consist of making sales or soliciting orders.¹¹²

III. Administration

The Franchise Tax Board¹¹³ is the administrator of the California income taxes. Its powers include among others adoption of regulations, the examination of records and issuance of subpoenas. The Board has appointed an Executive Officer and to a considerable extent its powers have been delegated to such officer.¹¹⁴ Organizationally the Board con-

¹¹⁰ Public Law 86-272.

¹¹¹ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

¹¹² See Appeal of Walter T. Dickerson Co., CAL. ST. BD. OF EQUAL., Oct. 27, 1953; CCH 1 CAL. TAX CASES ¶ 200-245; P-H STATE & LOCAL TAX SERV. Cal. ¶ 13136, holding a foreign corporation, not qualified to do business in California, subject to tax, where it maintained a salesman in California but had no place of business and no stock of merchandise in the state.

¹¹³ The Controller, Director of Finance and Chairman of the Board of Equalization constitute the Board, CAL. Gov. C. § 15700.

¹¹⁴ Powers reserved to the Board are:

- (a) To adopt rules and regulations.
- (b) To prescribe the extent, if any, to which any ruling or regulation shall be applied without retroactive effect.
- (c) To determine the rate of tax on banks and financial corporations.
- (d) To appoint and remove the Executive Officer.
- (e) Any powers or duties which by any provision of law shall be exercised or performed only by the Board.

18 CAL. ADM. C. Reg. 17003.

sists of three divisions, Administrative, Special Investigations and Operations.¹¹⁵ The heads of these divisions report to the Executive Officer.

A headquarters office is located in Sacramento, regional offices in Los Angeles and San Francisco, and branches in other cities¹¹⁶ throughout the state. Offices are also located in Chicago, Illinois, and New York City, New York, as bases for out-of-state audit operations. Extensive operations are carried out in both audit and enforcement fields and substantial additional revenues accrue to the state through these activities.¹¹⁷

The law embodies extensive provisions relating to the examination of returns, assessment of deficiencies and procedure for assessment where returns are due but have not been filed. These provisions are contained in Revenue and Taxation Code, sections 18581 to 18695, and 25661 to 25801. Normally adjustments are made by issuance of notices of proposed assessments which become final if not protested within sixty days. Jeopardy assessments are also issued and may also be contested if a bond is posted and a petition for reassessment is filed within ten days.¹¹⁸

If protests are filed in respect to proposed assessments or jeopardy assessments, the matters will be reviewed by a separate unit of the Board and a hearing may be had if the taxpayer so desires. The proceedings in such a hearing are informal and are usually held in an "across the desk" manner. In acting upon a protest the Board will either affirm, modify or withdraw the assessments, the taxpayer being notified by the issuance of a notice of action. The action on protests becomes final upon the expiration of thirty days from the mailing of the notice of action unless within this period the taxpayer files an appeal to the State Board of Equalization.¹¹⁹ A copy of such appeal must be filed with the Franchise Tax Board. Before the Board of Equalization on appeals the procedure is usually somewhat as follows:

The appellant will file an opening brief to which the Franchise Tax Board replies. The appellant then files a closing brief. At this time a hearing date will be set. At the hearing an attorney for the Board of Equalization will outline the issues and then each party is given an

¹¹⁵ Administration handles protests and appeals and various internal functions; Special Investigations handles criminal matters; and Operations handles audit, civil enforcement and general taxpayer services.

¹¹⁶ Branches are located in: Oakland, Fresno, San Jose, Santa Rosa, Stockton, Bakersfield, Long Beach, San Bernardino, San Diego, and Santa Barbara.

¹¹⁷ For the fiscal year ended June 30, 1959, net additional revenue of \$24,440,815.00 accrued from these activities. 1959 *Cost of Operation and Revenue Statement*, CAL. FRANCH. TAX BD.

¹¹⁸ CAL. REV. & T.C. §§ 18645, 25761a.

¹¹⁹ CAL. REV. & T.C. §§ 18593, 25666.

opportunity to present his views and to call witnesses, if desired. Witnesses are used in a relatively small percentage of the cases.

Decisions of the Board of Equalization on appeals are given in the form of written opinions, such opinions becoming final upon the expiration of thirty days from the date thereof, if no petition for a rehearing is filed by either party during such period.¹²⁰ At the appeal stage it is usual for the appellant and the Franchise Tax Board to explore the possibility of settlement and a number of cases are settled by stipulation.

Enforcement functions other than audit are largely directed toward obtaining returns from those who should have filed returns but have failed to do so. Leads as to these are obtained from information documents filed as to income payments, abstracts of returns obtained from federal files, and field investigations as to owners of assets. If returns are not filed when requested, the Board assesses the tax and under the applicable provisions no protest or appeal is allowed.¹²¹ The propriety of the assessment may, however, be contested by the claim procedure after payment of the tax.

Provisions as to claims are included in Revenue and Taxation Code sections 19051 to 19062, and 26071 to 26080. Claims for refund must be in writing and must state the specific grounds on which based. There is no statutory requirement that a hearing be granted on a claim but as a matter of practice the Board will grant such a hearing if requested. If a claim is denied, the denial becomes final unless an appeal is taken to the Board of Equalization within ninety days. This contrasts with the thirty-day period as to assessments. Procedure before the Board of Equalization is the same as for assessments. If the Franchise Tax Board fails to act on a claim within six months, the taxpayer may consider it denied and take his appeal.¹²²

If a taxpayer does not wish to follow the protest and appeal procedures available, or after exhausting them wishes to contest the tax further, he may file an action in the Superior Court against the Franchise Tax Board.¹²³ Prerequisites to such an action are payment of the tax, filing a claim for refund, and denial of the claim by the Franchise Tax Board or the passage of six months after filing without action by such Board. There is a single exception to this as to residence determination.¹²⁴ In such cases a taxpayer need not pay the tax before suit.

¹²⁰ CAL. REV. & T.C. §§ 18596, 25667.

¹²¹ CAL. REV. & T.C. §§ 18682, 25932.

¹²² CAL. REV. & T.C. §§ 19058, 26103a.

¹²³ CAL. REV. & T.C. §§ 19082-19092; 26101-26107.

¹²⁴ CAL. REV. & T.C. § 19081.

IV. Conclusion

With the rate increases and other changes made by the Legislature in 1959,¹²⁵ the Personal Income Tax and the Bank and Corporation Tax will become more important in future years. Substantial increases will be realized in revenue produced¹²⁶ and it is estimated that the per cent of revenue contributed to the General Fund by these taxes will rise to about 33 per cent for the fiscal year ending June 30, 1961. With further expansion of the economy these taxes may well produce an increasing share of the State's General Fund revenue, income taxes being more responsive to fluctuations in the level of economic activity than sales taxes.

¹²⁵ Changes were made in the rates of both personal and corporation income taxes and personal income tax "brackets," and personal exemptions and credits for dependents, capital gains provisions, standard deductions and allowances for depreciation. Considerable change will occur in the distribution of the personal income tax between income classes, with reductions for some taxpayers and increases for others. Almost all corporations will pay higher taxes; however, there may be some deductions because of changes in depreciation allowances.

¹²⁶ Budget estimates for collection under these taxes for the fiscal year ending June 30, 1960, are:

Personal income tax	\$239,500,000
Bank and corporation tax	221,200,000
Total	<u>\$460,700,000</u>

This is an estimated increase of 37.7% in total collections over the prior year. Cal. St. Budget, July 1, 1960, to June 30, 1961.